RS650-2

JAPAN · ECONOMIC · INSTITUTE

JEI REPORT

A Two-Part Report: A and B

NO. 1B
January 5, 1990

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Government Optimistic About FY 1990

When Tokyo released its economic outlook for fiscal year 1990 on December 22, 1989, some observers may have experienced deju vu, feeling that they had heard not only the government's argument but the differing private-sector perspective about a year earlier. In January 1989 Tokyo had said that it expected economic growth in the 12 months through March 1990 to slow modestly from the April 1, 1988-March 31, 1989 period but to be cushioned by a healthy rise in consumer spending. Private forecasters at that time saw things differently, expecting greater strength than did the government from plant and equipment spending and less from consumer spending, with overall real economic growth ending up a couple tenths of a percentage point above 4 percent.

Substitute "next year" for "this year" and one gets FY 1990's economic outlook. The government prediction of 4 percent real growth in FY 1990 is

exactly what it expected a year ago for the fiscal year now ending. All 13 banks and research institutes surveyed in December by the Japan Economic Journal think the government estimate of 7.3 percent real growth in capital spending is too pessimistic. Their forecasts of plant and equipment spending range from 7.4 percent to 10.5 percent. Seven of the 13 private forecasters are less optimistic than Tokyo about consumer spending. On balance, 11 of the 13 believe the overall growth rate will be higher than the 4 percent expected by the government, with estimates going as high as 5 percent.

As the Table shows, the private forecasts of a year ago are likely to be closer to the mark for FY 1989 than last January's official outlook. If the private forecasters erred, it was in being too close to the government figures; Tokyo now concedes that real economic growth for FY 1989 will be about 4.6 percent, led by plant and equipment spending, up a whopping 14.5 percent rather than the 9.2 percent expected a year ago. Conversely, consumer spending will grow only 3.2 percent rather than the 4.6 percent expected earlier.

Government's FY 1990 Economic Outlook

(percent change except where noted)

	Actual			Estimated	Projected
	FY 1986	FY 1987	FY 1988	FY 1989	FY 1990
Real Gross National Product	2.7%	5.4%	5.3%	4.6%	4.0%
Consumer Spending	3.4	4.5	5.0	3.2	4.6
Residential Construction	11.0	25.7	5.3	0.2	0.3
Private Capital Spending	4.3	10.1	17.3	14.5	7.3
Wholesale Prices	-9.4	-2.0	-0.7	3.5	0.6
Consumer Prices	0.0	0.5	0.8	2.7	1.6
Unemployment Rate (percent)	2.8	2.8	2.4	2.3	2.3
Yen-Dollar Exchange Rate	Y159.8	Y138.3	Y128.3	Y141.3	Y142.5
Current Account Surplus (billions of dollars)	$94.1	$84.5	$77.3	$61.0	$56.0
Trade Surplus (billions of dollars)	101.6	94.0	95.3	81.0	78.0

Source: Economic Planning Agency

Will business forecasters prove correct again? In past years the private consensus forecast has proved more accurate than the government outlook only about half the time. Certainly, Tokyo could argue that economic forecasting resembles weather forecasting: getting the timing right can be tricky. The government may have been wrong about the pace of the slowdown in economic growth but right about its eventual occurrence, much as a weather pattern often takes longer than expected to arrive.

Government and private forecasters agreed on many aspects of the economy's performance a year ago and generally are in harmony again this year. The

current account balance and the trade surplus in dollar terms have declined substantially. The drops, in fact, have been much larger than either side anticipated, due to booming domestic demand and the yen-dollar exchange rate being more favorable to the dollar than the one initially penciled in, thus leading to a J-curve effect. Both the private forecasts and the government outlook assume a considerable slowing of progress on the trade front in the coming fiscal year. However, despite these developments, Tokyo expects the external sector to cut economic growth in FY 1989 by 0.7 percentage point, exactly as it expected a year ago, and to shave another 0.5 point off the expansion rate in FY 1990. If these figures prove accurate, by the end of March 1991 Japan will have seen net exports shrink for five straight years.

On balance, the consensus of private and public forecasters is for more of the same on nearly all economic fronts. Given Japan's outstanding economic performance in recent years, that outlook has to be encouraging to Japanese politicians facing an election. Washington, of course, has its concerns over the numbers, especially current and prospective plant and equipment spending, which it fears could lead to higher exports, but generally the macroeconomic performance of Japan has been one of the bright spots in the bilateral relationship. In early 1987 the United States wanted Japan to get its economy rolling; virtually no one in Washington can deny that Japan has done just that.

Douglas Ostrom

BOJ Ushers In 1990 With Higher Discount Rate And New Leader

As 1989 dawned the Bank of Japan's discount rate seemed just short of being etched in stone: it had been kept at the same 2.5 percent level since February 1987. The rate is the charge BOJ assesses its bank borrowers and directly influences a wide variety of interest rates on savings, home loans and corporate borrowing. Against that background few could have been prepared for what 1989 would bring. The bank raised the rate three times in 1989, the last instance being a half percentage point hike on Christmas Day. At yearend the rate stood at 4.25 percent, a level it last reached in early 1986.

In reaching its decision BOJ and its new governor, Yasushi Mieno, who had taken office only nine days earlier, were influenced by the same set of factors that had been decisive concerning the earlier hikes. Economic forces were all pointing to the same decision October 11, for example, when BOJ had raised the rate half a point (see JEI Report No. 40B, October 20, 1989). During 1989 rising consumer and business demand had led to labor and product shortages and produced inflationary pressures, although prices still are only edging upward. By its modest contribution BOJ hopes to help cool domestic demand by making borrowing more expensive. In addition, the rise in rates is expected to make Japanese investors more likely to keep their money at home, thereby reducing the demand for dollars and other foreign currencies and propping up the yen in international money markets. Through much of 1989 the yen appeared to be in need of such support as it continuously lost ground against the dollar and several other major currencies.

In deciding to raise the rate a third time in December BOJ apparently felt that the earlier boosts had not been enough. The yen had varied little against the dollar between October and December, for example, despite the earlier increases. In Europe, Japan and the United States worries were mounting

that the sustained weakness of the yen could lead to an upturn in Japan's already large trade surplus.

BOJ's repetitive hikes in the discount rate can be regarded as a preemptive strike against such a possibility. As such, they mesh neatly with Washington's strategy, which has leaned toward a looser monetary policy -- and lower interest rates -- in an effort to prevent a sharp U.S. economic downturn. An extra bonus of the U.S. policy has been a downward push on the dollar, although that effect so far has been minimal against the yen. In short, Japanese and American policies, through opposite domestic economic actions, both are trying to push the yen higher against the dollar.

While Washington policymakers presumably applauded the latest BOJ move, decisionmakers in Tokyo, at least initially, were less enthusiastic. In response to mid-December statements by BOJ officials that led many experts to conclude a hike was imminent, Minister of Finance Ryutaro Hashimoto hastened to dampen such speculation. Although in this instance the discount rate increase eventually was implemented, Mr. Hashimoto's word carried considerable weight since MOF and BOJ cooperate closely and BOJ seldom acts independently. In fact, MOF and BOJ alternate in providing governors for BOJ. The latest public disagreement coincided with BOJ's retiring leader, Satoshi Sumita, an MOF career official, handing over the post to Mr. Mieno, who has worked his way up through BOJ.

BOJ governors serve five-year terms, making them relatively permanent fixtures in Japanese economic policy. Mr. Sumita's tenure spanned that of four Japanese prime ministers, albeit with three of those in the last year. With the Diet's upper house likely to be in opposition hands throughout his term in office, the political environment in which Mr. Mieno will have to operate could be particularly difficult. How well BOJ's technical skills mesh with political imperatives will get an early test in the first part of 1990, when lower house elections are all but certain. BOJ's concerns -- with the potential, rather than the reality, of dangerous inflation and with the possibility of a growing trade imbalance, which recently has been subsiding -- suggest a longer-term perspective than that of politicians, who half a year from now could be out of office.

While the Japanese economy remains extraordinarily healthy, the higher interest rates BOJ policies already have brought in their wake are surely anathema to politicians who have to face voters concerned with higher mortgage and other consumer lending rates, for example. Whatever the favorable consequences of higher interest rates for the nation's long-run economic health, politicians may not necessarily equate these policies with their own political well-being.

Douglas Ostrom

FY 1989 Supplemental Budget Approved

On December 29 the cabinet of Prime Minister Toshiki Kaifu approved a Ministry of Finance proposal to add nearly Y5.9 trillion ($42.1 billion at Y140=$1.00) to the central government's spending plan for fiscal 1989 (ending March 31, 1990). The supplemental budget allows Tokyo to meet unpredictable

FY 1989 Initial, Supplemental and Revised General Account Budget

(in billions of yen)

Initial FY 1989 (affected categories only)		Supplemental FY 1989		Revised FY 1989
Revenues				
Taxes	Y51,010.0	Taxes	Y3,217.0	Y54,227.0
Nontax Revenues	2,293.2	Nontax Revenues	344.4	2,637.6
Bonds	7,111.0	Bonds	0.0	7,111.0
Construction	5,780.0	Construction	650.0	6,430.0
Deficit Financing	1,331.0	Deficit Financing	-650.0	681.0
		Carryover from FY 1988	2,336.3	2,336.3
		Expenditures	1,732.1	
		Transfers to Local Governments	604.2	
Total	60,414.2	Total	5,897.7	66,311.9
Expenditures				
Transfers to Local Governments	13,368.8	Transfers to Local Governments	1,595.9	14,964.7
		FY 1988 Surplus	604.2	
		FY 1989 Natural Increase	991.7	
Social Welfare	10,894.7	Social Welfare	1,560.0	12,454.7
		Public Welfare Insurance	1,500.0	
Public Works	6,130.7	Public Works	1,304.6	7,435.3
Disaster Relief	66.7	Disaster Relief	425.6	492.3
Housing Development	764.4	Housing and Urban Development	775.7	1,540.1
Social Capital	1,300.0	Social Capital	267.7	1,567.7
Food Control Programs	418.2	Agricultural Programs	50.0	468.2
Small Business Measures	194.2	Business Measures	171.4	365.6
Miscellaneous Outlays	4,058.1	Miscellaneous Outlays	81.9	4,140.0
		Wage Increases	54.6	
		Japanese Railways Debt Liquidation	450.0	
		Miscellaneous Reductions	-760.5	
		Other	337.8	
		National Debt Redemption	866.1	866.1
Total Expenditures	60,414.2	Total Supplement	5,897.7	66,311.9

needs, such as disaster relief, and to handle any surplus or deficit from the previous fiscal year. For the second year in a row, however, Tokyo also has used the supplemental budget to expand foreign-oriented programs.

Revised revenue estimates for FY 1989 show that Tokyo continues to suffer from an embarrassment of riches (see Table). Tax revenues are projected to be more than 6 percent above the initial estimate thanks to strong economic activity. The surplus carried over from the previous fiscal year also will be significant (Y2.3 trillion or $16.7 billion), though less than the FY 1987 carryover (just under Y3 trillion or $21.3 billion). The extra income allows MOF to cut the issue of deficit financing bonds in half, in line with the government's pledge to eliminate new issues of such bonds by FY 1990. The effect on the total amount of debt issued, however, will be zero since an equivalent amount of construction bonds has been added.

On the expenditure side the FY 1989 supplement contains many of the usual items: the majority of disaster relief funds; a strong increase in other public works spending; a Y50 billion ($357.1 million) boost in spending for small business programs and a special allotment of Y121.4 billion ($867.1 million) for the silk industry; a wage hike for civil servants (Y54.6 billion or $390 million); and miscellaneous administrative costs and cost savings. There are some new items as well: Y450 billion ($3.2 billion) to pay off some of the ex-Japanese National Railways' huge long-term debt (currently about Y27 trillion or $192.9 billion) and funds for a high-speed underground rail line (Y1 trillion or $7.1 billion). Foreign-oriented programs also get a boost: Y32.7 billion ($233.6 million) for developing country aid and Y50 billion ($357.1 million) for art and cultural exchanges. A savings in administrative costs of Y760.5 billion ($5.4 billion) shows that Tokyo remains committed to shrinking the size and the cost of government, a policy initiated in the early 1980s.

From an aggregate standpoint, the additional funding will push total spending for FY 1989 over Y66.3 trillion ($473.7 billion), a 7.2 percent increase over the revised FY 1988 budget. Deficit borrowing will decline to just over 1 percent of the total budget, a far cry from the 32.7 percent level at the beginning of the decade. The additions to public works outlays and business support programs will help counteract the deflationary effect of balancing the budget.

Jon Choy

Cabinet Sets FY 1990 Spending Plan

Prime Minister Toshiki Kaifu's cabinet on December 29 approved the fiscal plan for the year beginning April 1, 1990, paving the way for Diet consideration of the spending measure. At Y66.3 trillion ($473.4 billion at Y140=$1.00) the initial budget for FY 1990 is nearly 10 percent more than the comparable FY 1989 plan. The gain surpasses any initial increase of the previous decade and virtually equals total spending in the revised FY 1989 budget. Although most of the increase is nondiscretionary, discretionary spending is up nearly 4 percent as well. Tokyo's commitment to foreign aid and defense is unmistakable, as is its continued focus on stimulating domestic demand.

A review of discretionary spending shows a familiar pattern; Tokyo continues to favor certain categories at the expense of others (see Table 1). At

Table 1: Summary of General Account Outlays, FY 1989-FY 1990

(in billions of yen)

	Initial FY 1989	Initial FY 1990	Change
Discretionary Items			
Social Security	¥10,894.7	¥11,614.8	6.6%
Education and Science	4,937.1	5,112.9	3.6
Pensions	1,855.8	1,837.5	-1.0
Defense	3,919.8	4,159.3	6.1
Economic Cooperation	733.9	784.5	6.9
Public Works	6,130.7	6,148.0	0.3
Disaster Reconstruction	66.7	66.7	0.0
Small Business Measures	194.2	194.3	0.1
Food Control Programs	418.2	395.2	-5.5
Energy Measures	527.5	547.6	3.8
Other	4,051.9	4,198.3	3.6
Reserves	350.0	350.0	0.0
Total	34,080.5	35,409.1	3.9
Nondiscretionary Items			
Transfers to Local Governments	13,368.8	15,275.1	14.3
Debt Service	11,664.9	14,289.3	22.5
Transfer of NTT Proceeds to Public Works	1,300.0	1,300.0	0.0
Total	26,333.7	30,864.4	17.2
Total	60,414.2	66,273.6	9.7

the top of the favored list for FY 1990 is foreign economic cooperation with a 6.9 percent increase, followed by social welfare (6.6 percent) and defense (6.1 percent). The increase in economic cooperation includes an 8.2 percent expansion of Japan's official development assistance program. The initial Ministry of Finance proposal contained only a 5.9 percent increase in ODA, but the Ministry of Foreign Affairs argued successfully for a heftier raise (see article in this issue). The jump in social spending reflects government preparations for the increasing number of retirees that are expected in the coming decade. After years of neglect, the growth of social welfare spending will outpace that of defense. The planned expansion of defense outlays, nonetheless, will allow the Japan Defense Agency to complete the current five-year procurement plan (see following article). Despite the increase, defense spending is projected to fall below the politically sensitive level of 1 percent of gross national product due to estimated economic growth for FY 1990 of between 4 and 5 percent in real terms (see article in this issue).

Increases in spending for education/science and energy programs represent victories for far-sighted bureaucrats. Sharply higher energy consumption and a carefree attitude about conservation have made planners within the Ministry of International Trade and Industry edgy. The growth of science-related spending represents, at least in part, a consensus that Japan must devote more money to basic research, not only to support continued advances in commercial technology but to expand technological cooperation with foreign countries.

On the nondiscretionary side, booming tax receipts mandate the sharp increase in revenue-sharing with local governments. The leap in debt service costs underscores the government's concern over balancing the budget and reducing the outstanding debt. The transfer of Y1.3 trillion ($9.3 billion) in funds from the sale of government-held shares of Nippon Telegraph and Telephone Corp. again will be channeled into public works spending to bolster domestic demand and improve the quality of life.

The government's estimates of FY 1990 revenues mirror the trends in nondiscretionary spending (see Table 2). Tax and stamp revenues are projected to grow a strong 13.7 percent in spite of the uncertainty surrounding the future of the controversial 3 percent consumption tax. The Ministry of Finance recently announced that it would offer 1.95 million shares of NTT to the public in FY 1990 after having postponed a similar issue in FY 1989 due to unfavorable market conditions. These revenue increases will permit the government to keep its pledge of eliminating new issues of deficit-financing bonds in FY 1990 while also cutting back sharply on the total amount of new borrowing (see JEI Report No. 47B, December 15, 1989).

Table 2: Summary of General Account Revenue Estimates, FY 1989-FY 1990

(in billions of yen)

	Initial FY 1989	Initial FY 1990	Change
Tax and Stamp Receipts	Y51,010.0	Y58,004.0	13.7%
Nontax Receipts	993.2	1,339.6	34.9
Proceeds from Sale of NTT shares	1,300.0	1,300.0	0.0
Bonds	7,111.0	5,630.0	-20.8
Construction	5,780.0	5,630.0	-2.6
Deficit Financing	1,331.0	0.0	-100.0
Total	60,414.2	66,273.6	9.7

The cabinet approved at the same time MOF's outline for the Fiscal Investment and Loan Program, a second capital budget. FILP provides funds to various governmental and semigovernmental organizations that are involved in a wide range of public works. FILP allocations are up sharply in FY 1990 (see Table 3) for social infrastructure (17.2 percent), welfare agencies (15.7 percent) and public housing (12.1 percent). FILP also is a major channel for Japan's foreign aid projects, encompassing the budgets of the Japan Development Bank and the Export-Import Bank of Japan. In line with Tokyo's commitment to increase foreign aid, FILP funds for trade promotion and economic cooperation will rise 12.9 percent.

As for the source of FILP funds (Table 4), the link between FILP and the general account budget is growing increasingly tenuous: funds transferred from the general account budget to FILP through the Industrial Investment Special Account will drop by nearly a quarter in FY 1990 to a nearly insignificant level. Reflecting concern over the aging of Japan's society, the government Trust

Table 3: Fiscal Investment and Loan Program Outlays, FY 1989-FY 1990

(in billions of yen)

	Initial FY 1989		Initial FY 1990	
	Amount	Change	Amount	Change
Housing	Y7,460.6	7.8%	Y8,365.9	12.1%
Public Service Facilities	4,371.3	-1.8	4,222.0	-3.4
Welfare	736.0	11.2	851.9	15.7
Education	520.2	-18.4	554.1	6.5
Small Business	4,176.4	3.6	4,337.8	3.9
Agriculture	924.4	-5.6	876.0	-5.2
Land Conservation and Disaster Reconstruction	357.9	-12.7	328.5	-8.2
Roads	2,576.8	2.6	2,700.1	4.8
Transportation and Communications	2,361.6	5.9	2,304.1	-2.4
Regional Development	676.6	3.7	682.5	0.9
Industry and Technology	758.7	10.4	796.5	5.0
Trade Promotion and Economic Cooperation	1,420.0	21.3	1,603.0	12.9
Capital Utilization	5,930.0	38.9	6,950.0	17.2
Total	32,270.5	9.0	34,572.4	7.1

Table 4: Fiscal Investment and Loan Program Sources, FY 1989-FY 1990

(in billions of yen)

	Initial FY 1989		Initial FY 1990	
	Amount	Change	Amount	Change
Industrial Investment Special Account	Y85.2	-6.6%	Y64.1	-24.8%
Trust Fund Bureau	26,871.3	2.5	28.453.3	5.9
Postal Savings	8,500.0	7.6	7,200.0	-15.3
Pension Contributions	4,310.0	23.1	5,540.0	28.5
Other Revenues	14,061.3	-5.0	15,713.3	11.7
Postal Life Insurance Fund	5,614.0	27.3	6,055.0	7.9
Government-Guaranteed Bonds and Borrowings	2,000.0	-16.9	2,000.0	0.0
Total	34,570.5	4.4	36,572.4	5.8

Fund Bureau will invest sharply more funds from its pension accounts. Receipts from the postal savings system will fall, in contrast, as a result of Tokyo's efforts to reform and liberalize Japan's financial system.

The negotiations between the Ministry of Finance and other agencies over final spending levels went smoothly this year. MOF presented its draft budget to the cabinet December 24 and interministry negotiations ended late December 28. Final increases in a majority of the spending categories (see Table 5) indicate an easing of the fiscal austerity that had stifled spending since the

Table 5: Comparison of Proposed and Approved FY 1990 Discretionary Outlays

(in billions of yen)

	Proposed	Approved
Social Security	Y11,573.2	Y11,614.8
Education and Science	5,028.3	5,112.9
Pensions	1,797.4	1,837.5
Defense	4,135.0	4,159.3
Economic Cooperation	769.1	784.5
Public Works	6,148.0	6,148.0
Disaster Reconstruction	66.7	66.7
Small Business Measures	191.1	194.3
Food Control Programs	395.2	395.2
Energy Measures	534.1	547.6
Other	4,321.1	4,198.3
Reserves	350.0	350.0
Unallocated Expenses	100.0	--

early 1980s. MOF was willing to restore funds for arguably "nonessential" items, such as regional development (former Prime Minister Noboru Takeshita's furusato or home town program, for example, received a Y300 billion or $2.1 billion boost) and advanced railcar development, which was allotted Y520 million ($3.7 million) for a linear-motor test track. Final budget negotiations also yielded more money for such international concerns as import promotion (Y7 billion or $50 million for a Ministry of International Trade and Industry program) and global environmental concerns (a total of Y447 billion or $3.2 billion).

Although the budget now is ready for submission to the Diet, domestic political considerations may delay the process. While business leaders praised the cabinet's budget as successfully addressing the contradictory problems of balancing the budget and expanding public works, opposition parties blasted the spending plan for a dearth of programs that would raise the country's standard of living and provide for the growing elderly population. Equally important, the Japan Socialist Party attacked the budget for including the controversial 3 percent consumption tax. The JSP pledged to do all it could to block passage of the budget in the Diet's upper house, which the ruling Liberal Democratic Party does not control.

Prime Minister Kaifu reportedly has given up hope of getting even the FY 1989 supplemental budget approved by the current Diet, which opened briefly December 25 and immediately recessed. According to press reports, the LDP and the government have agreed to reopen the Diet January 22 (four days after Mr. Kaifu returns from a trip to Europe) and dissolve the legislative body two days later in response to expected moves from the opposition parties. This would set up February 18 as election day for the lower house and delay consideration of both the FY 1989 supplemental budget and the FY 1990 budget until some time after that. The LDP already is planning for a temporary budget if the FY 1990 spending plan is not approved before the start of the fiscal year, an almost certain occurrence.

Jon Choy